

Testimony in Favor of HB 185
Expanding the State Income Tax Deduction for 529 Plan Contributions
to Include Out-of-State Plans

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I. 529 Background and Basics

- Created by Section 529 of the federal tax code in 1998.
- Grow tax-free.
- Qualified withdrawals are also tax-free.
- 529 Plans investments are managed by large mutual fund/life insurance companies and are sponsored by individual states.
- Investors can put their money in almost any 529 plan they choose, but MAY receive a state income tax benefit by investing in their home state's plan.
- Montana offers a deduction from Federal AGI of up to \$3,000 per taxpayer (\$6,000 if MFJ) for contributions to our state-sponsored plan.

II. Montana's Current 529 Offerings

- There are two Certificates of Deposit (CD's) available through College Savings Bank (a subsidiary of Pacific Life).
- One CD pays rates that are (loosely) tied to the rate of inflation of college costs.
- The other CD pays rates that are (loosely) tied to the performance of the S&P 500 Stock Index.
- Pacific Life Funds offers investments in the stock and bond markets via "funds of funds portfolios".
- There are 5 portfolios available, ranging from "Conservative" to "Aggressive".
- These portfolios are available to Montanans under a "Direct Sold" option, whereby the sales charges (loads) can be avoided.

III. Problem with Current Situation

- **CollegeSure CD** does not keep up with the rate of college inflation. (Currently yielding 2.49% versus while the annual rate of college inflation has averaged 5.37% annually over the past 10 years.)
- **InvestorSure CD** has returns that are linked to the return of the S&P 500 Stock Index. However, due to participation rates, the absence of reinvested dividends and the averaging of quarterly returns, the Investor Sure CD's upside potential is severely limited. *For example:* According to past marketing material for the InvestorSure CD, from 11/1/2002 through 11/1/2007, their product would have had an average annual return

of 5.66%. A direct investment in the S&P 500 Index over the same time period would have returned 13.88% annually.

- **Pacific Life Mutual Fund Portfolio**

1. **MOST EXPENSIVE PLAN IN THE NATION** as of 12/1/08.
2. **Historic returns are not competitive.**
3. No age-based options.
4. Expensive sales charges (loads). Nearly 60% of Montanans who invested in this plan in 2007 went through brokers and paid sales charges, rather than using the "Direct Sold" option.

IV. Proposed Solution—HB 185

- Would allow Montanans to claim the Montana tax deduction for contributions to ANY qualified 529 plan, freeing them to choose from the best-performing and lowest-cost options available in the nation.
- Would provide incentive for Pacific Life to become more competitive, as they would no longer be the ONLY plan that is subsidized by the Montana Income Tax Deduction.
- Past efforts to "fix" the Montana 529 plan have failed, due to lack of interest from other vendors and lack of incentive for Pacific Life to make changes. This solution addresses both of those issues.
- Worries about loss of revenue to the State are unjustified. The current plan has not historically generated significant revenue and was never intended to.

V. Summary

- Montana's current 529 offerings are either too conservative for long-term investors, or too expensive.
- HB 185 would allow Montana residents to choose among the very best plans in the country when saving for college.
- **ENCOURAGING MONTANANS TO UTILIZE BETTER INVESTMENTS WHEN SAVING FOR COLLEGE WOULD BE A MORE EFFECTIVE USE OF STATE FUNDS THAN WHAT IS HAPPENING CURRENTLY.**

Table 1

5-Year Annualized Returns (as of December 31, 2008)

	Montana (Pacific Life) Direct Sold	Montana (Pacific Life) with Sales Load	Utah (Vanguard)	Alaska (T. Rowe Price)	
Conservative Portfolio	1.39%	0.25%	3.01%	2.49%	20% Stocks, 80% Bonds/Cash
Moderate-Conserv. Portfolio	0.62%	-0.51%	2.05%	1.59%	40% Stocks, 60% Bonds/Cash
Moderate Portfolio	0.03%	-1.09%	1.14%	0.49%	60% Stocks, 40% Bonds/Cash
Moderate-Aggressive Portfolio	-1.14%	-2.25%	0.14%	-0.39%	80% Stocks, 20% Bonds
Aggressive Portfolio	-2.08%	-3.18%	-1.53%	-1.33%	+95% Stocks, -5% Bonds

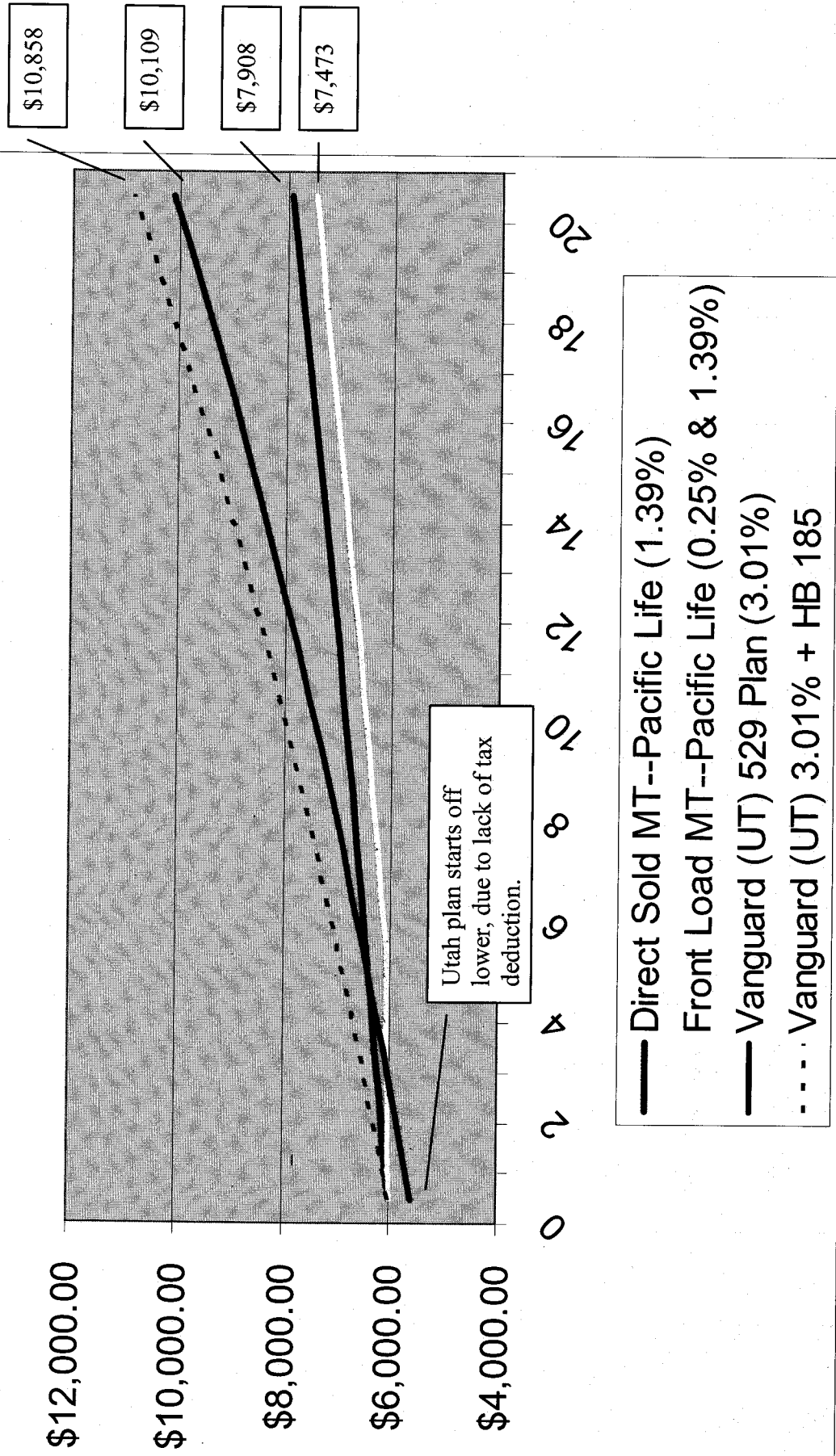
42% of MT \$'s 58% of MT \$'s

Comparison of Fund Expenses

Table 2

	Montana (Pacific Life)		Utah (Vanguard)		Alaska (T. Rowe Price)	
	Total Annual Fees (%)*	Cost of \$10,000 Investment over 10 years	Total Annual Fees (%)	Cost of \$10,000 Investment over 10 years (non- resident)	Total Annual Fees (%)	Cost of \$10,000 Investment over 10 years (non- resident)
Conservative Portfolio	1.190%	\$2,340	0.276%	\$594	0.82%	\$1,253
Moderate-Conserv. Portfolio	1.260%	\$2,297	0.300%	\$624	0.87%	\$1,311
Moderate Portfolio	1.320%	\$2,321	0.323%	\$652	0.92%	\$1,369
Moderate-Aggressive Portfolio	1.370%	\$2,373	0.340%	\$673	0.92%	\$1,369
Aggressive Portfolio	1.420%	\$2,444	0.298%	\$620	0.92%	\$1,369

Hypothetical Investment of \$6,000 (Conservative Portfolio)



Growth of \$20.5M investment in MT Plan vs. Out-of-State Plan

